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MEMORANDUM FOR: Bill Casey

17 OCT 1983

FROM: Mac Baldrige *Mac*
SUBJECT: Economic Roundup

Enclosed is the September issue of our Monthly Economic Roundup.

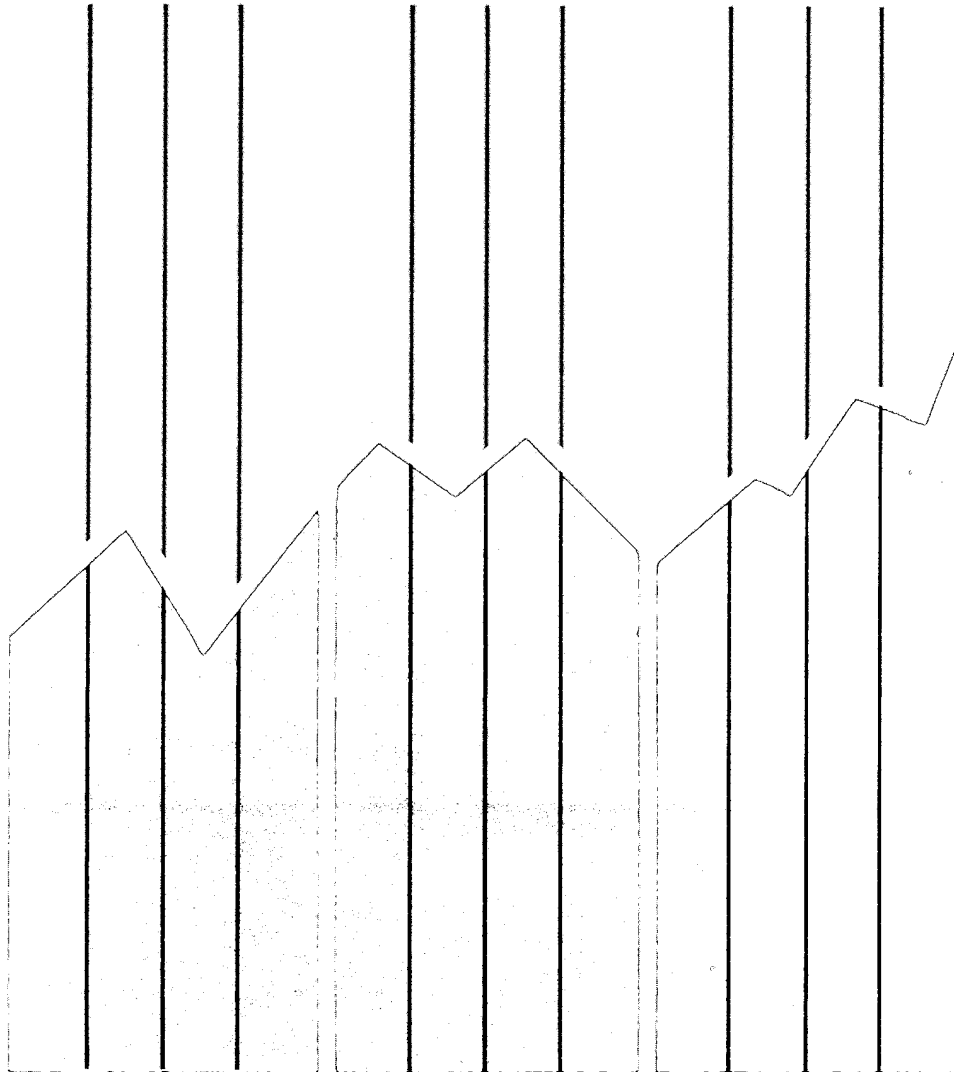
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The Economic Roundup



A MONTHLY REVIEW OF
ECONOMIC DEVELOPMENTS



Office of Economic Affairs
U.S. Department of Commerce

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THE ECONOMIC ROUNDUP

A Monthly Review of Economic Developments

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September 1983

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Data released in September show that the economic recovery thus far, as measured by GNP, industrial production and employment, has equaled the average performance of previous recoveries. The Commerce Department's "Flash" estimate of third-quarter real growth puts real GNP 4.8 percent above its 1982 fourth-quarter level, matching the average progress for the first 3 quarters of the preceding 6 recoveries.

The sectoral profile of the recovery is also comparable to those of previous upturns.

- Businesses are beginning to rebuild inventories after a very large run-off.
- After its robust performance in the first half, growth in residential construction is slowing.
- Auto production increased sharply during the first 3 quarters of the year and is now leveling off.
- Spending for non-auto consumer goods and services showed little net progress between June and August, but this pause helped to lift the personal saving rate to a more normal level. Moderate growth should resume.
- According to the Bureau of Economic Analysis' most recent plant and equipment survey, firms are planning significant increases in investment spending during the second half of 1983.

In the second quarter, households borrowed heavily to finance homes and consumer durables, while non-financial businesses had little need for funds. Federal, state and local governments stepped up their borrowing, but much of the increase was returned to the credit markets by increased lending.

Risks of the expansion stalling are small.

- Improved cash flows are dampening business demands for credit.
- Monetary growth moderated enough recently to bring the aggregates within their target ranges.

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- Interest rates remained essentially unchanged since early August but drifted down in the last two weeks of September.
- Relatively high interest rates in the U.S. have kept the foreign exchange value of the dollar up, depressing exports and boosting imports. However, exports are beginning to grow modestly.
- Inflation risks appear to be minor through 1984. Adverse weather conditions this summer will boost food prices in 1984, but the impact on the consumer price index will be relatively small. Wage settlements, for the most part, continue to be modest. Capacity pressures have not developed although capacity utilization in some industries is more than half-way back to previous peaks.

Recovery Profile is Normal

Data released in September show that the economic rebound has matched the average performance of previous recoveries.

- After a slow start in the first quarter, real GNP grew at a 9.7-percent annual rate in the second quarter and, according to the Commerce Department's "Flash" estimate, advanced at a 7-percent rate in the third quarter. If this preliminary third-quarter estimate holds, growth during the two middle quarters of 1983 was the fastest back-to-back advance in over 10 years. Real GNP now stands 1.7 percent above its previous peak in the third quarter of 1981. The estimated 4.8-percent real growth since the recession trough almost exactly matches the 4.9-percent average performance for the first three quarters of the preceding 6 recoveries.
- Industrial production rose by 0.9 percent in August, following a February-July pace of 1.6 percent per month. The 11.6-percent pickup since the recession trough exceeds the 9.7-percent average for the previous 6 recoveries.
- Payroll employment has grown 1.9 percent since the recession trough, if adjusted for strikes in August. This gain is in line with a 2.0-percent average increase during the first 9 months of the previous 6 recoveries. Employment, as measured by the survey of households (which is not affected by strikes), posted another strong advance in August, and has shown faster improvement than in previous upturns. The unemployment rate, after dramatic improvement, edged up 0.1 percentage point to 9.4 percent, due to higher labor force participation.

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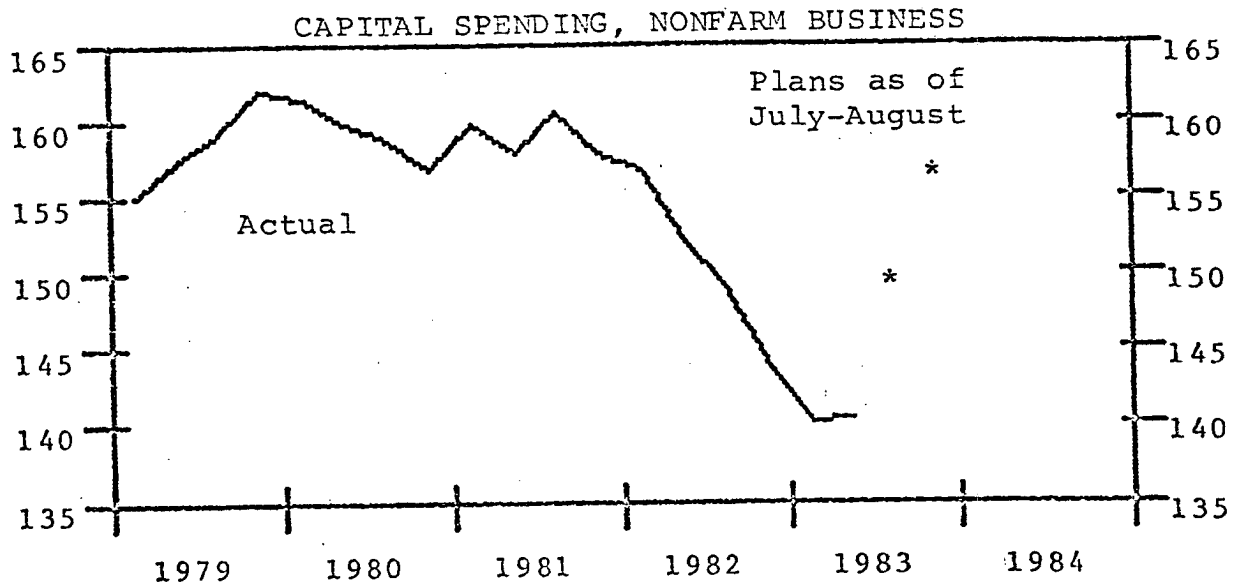
The sectoral profile of the recovery thus far also is comparable to those of previous upturns. The initial surge in activity due to the end of inventory liquidation, growth of residential construction and consumer durable goods spending is moderating, while business outlays for inventories, plant and equipment are beginning to rise.

- The "Flash" projection of third quarter GNP assumes some accumulation of inventories, following record liquidation during the preceding 3 quarters. Though business sales slipped 0.4 percent in July, the inventory-sales ratio, at 1.36, was only marginally above June's 1.35, the lowest level since 1967.
- Housing starts, which had fluctuated around a 1.75-million unit annual rate during the first 7 months of the year, unexpectedly jumped 8.4 percent to a 1.94-million unit rate in August, its best performance since December 1978. The August level was 15 percent above the second-quarter average, and most of the recent strength has been concentrated in multi-unit projects with long completion times. Residential construction should continue to grow through year-end, though the gains will be less than during the preceding 3 quarters.
- Auto production, a typical recovery leader, contributed 1.3 percentage points to real growth during second quarter and about 2.0 percentage points in the third. Current plans indicate a contribution of only 0.5 of a percentage point to fourth-quarter growth. Some of the added production is replenishing depleted stocks. Domestic new car sales fell from a 7.5-million unit annual rate in June to 6.6 million in August before rising to a 7.2-million unit rate in the first 20 days of September.
- Real household purchases of consumer goods other than autos leveled off in the current period, after growing rapidly in the first two quarters of the year. With production, employment and earnings continuing to expand and the savings rate rising to a more normal 5.2 percent in August from 3.6 percent in June, consumer spending should resume moderate growth.

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- Nonfarm businesses plan to increase plant and equipment expenditures by 11 percent in the second half of this year. Because prices for these goods are edging down, real growth would be about 12 percent, the strongest initial recovery since 1954. The 1981-82 decline, however, was also very large, exceeded recently only by the drop during the 1973-75 recession.



Credit market borrowing associated with these spending patterns is shown in the table below.

Funds Raised in Credit Markets
(\$Billions, Seas. Adj. Annual Rate)

	1982:2	1982:3	1982:4	1983:1	1983:2
Households	100.0	78.4	98.7	125.7	183.6
Nonfinancial Corporations	74.8	90.0	22.0	37.9	38.5
Noncorporate Business	48.2	37.3	30.6	30.1	38.0
State and Local Governments	40.5	30.4	56.2	28.9	66.8
U.S. Government	118.3	206.5	224.4	196.1	264.2
Foreign	13.9	11.9	25.3	15.8	19.6
Total Nonfinancial	395.8	454.5	452.3	434.5	610.7

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- Households more than doubled their borrowing since the third quarter of last year when interest rates began to fall. Non-financial corporations, on the other hand, borrowed at less than half the rate of last year's third quarter, reflecting inventory liquidation, postponement of investment projects, and improved cash flow.
- Total borrowing by nonfinancial sectors jumped an enormous \$176 billion in the second quarter. In addition to households, the U.S. Treasury and State and local governments raised substantial amounts. Excessive credit market pressures were avoided because the Treasury and State and local governments also increased their supply of funds to the credit markets. The Treasury built up its cash balances, while State and local governments invested the proceeds of advance refunding in U.S. Treasury securities.
- Households substantially increased their supply of funds to the markets, shifting their holdings from deposits, which are part of the monetary aggregates, to market securities, which are not, as shown below. Variation in the growth of total holdings has been small compared to the shifts among the various financial assets.

Household Acquisition of Financial Assets
(\$Billions, Seas. Adj. Annual Rate)

	<u>1982:2</u>	<u>1982:3</u>	<u>1982:4</u>	<u>1983:1</u>	<u>1983:2</u>
Credit Market Instruments	56.3	55.7	83.2	-1.3	93.4
Deposits and Currency	98.5	106.8	228.3	344.0	243.0
Money Market Mutual Funds	40.5	88.1	-68.1	-105.2	-62.7
Insurance and Pension Reserves	91.0	86.8	86.1	83.7	87.1
Total	286.3	337.4	329.6	321.2	360.8

High interest rates relative to those abroad and international financial troubles have kept the exchange value of the dollar high, depressing exports and boosting imports. In August, the merchandise trade balance posted a record deficit of \$7.2 billion. Imports rose 3.6 percent largely due to a seasonal rise in oil imports. Exports changed little in August, but the July-August average was 2.5 percent above the second-quarter low, with sales to Western Europe up 4.8 percent and those to Mexico up 20.7 percent.

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Near-Term Risks to the Expansion are Small

The current expansion could be hindered by extraordinary credit pressures, greater Fed restraint, or rising inflation from a variety of sources including supply constraints in some industries. None of these factors seems to be an immediate problem.

Credit pressures have developed in past expansions as businesses increasingly depended on external funds to finance rising inventories and plant and equipment expenditures. Business investment is beginning to recover, but cash flow also has grown strongly.

- The current low level of inventories relative to sales in most sectors of the economy and the prospect for rising sales will prompt firms to add to inventories. Furthermore, the most recent survey of non-farm businesses' capital spending plans implies strong contributions to third- and fourth-quarter real growth.
- Capital expenditures of nonfinancial corporations jumped in the second quarter of this year primarily because inventory liquidation ended. Profits also rose, however, so that for these corporations as a whole, internal funds still exceeded expenditures. This favorable relationship should not change materially during this year, as profits will continue to improve.

Nonfinancial Corporations, Excluding Farms
(\$Billions, Seas. Adj. Annual Rate)

	1981	1982	1983:1	1983:2
Internal Funds	245.0	214.3	243.0	273.2
Capital Expenditures	285.2	239.6	204.1	261.9
Deficit (-) or Surplus	-40.2	1.7	38.9	11.3

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All the monetary aggregates are within their targets, and a strong upsurge does not seem likely soon. Interest rates drifted down in recent weeks, reversing the upward trend from May to August.

- With August increases of only 0.2 percent for M1 and 0.5 percent for both M2 and M3, the monetary aggregates remained well within their target ranges. Interest rate ceilings on most time deposits will be removed on October 1st. Shifts among deposits may occur, but it seems unlikely that new ceiling-free time deposits will be able to attract funds from nondeposit assets as the money market deposits accounts did early this year.
- After falling dramatically during the latter part of last year, interest rates held steady for the first 4 months of this year before rising about 50-60 basis points between May and August. Since then, rates have slipped again.

Interest Rates

	<u>Fed Funds*</u>	<u>3-month T-bills (auction)</u>	<u>AAA Corp. Bonds</u>	<u>Mortgage Commitments</u>
June 1982	14.15	12.11	14.81	16.70
December 1982	8.95	8.01	11.83	13.62
June 1983	8.98	8.82	11.74	12.87
Week of				
July 11-15	9.21	9.07	12.13	13.50
August 15-19	9.67	9.43	12.40	13.89
September 12-16	9.54	9.04	12.40	13.72
September 19-23	9.48	8.99	12.31	13.72

*Week ended Wednesday of specified week.

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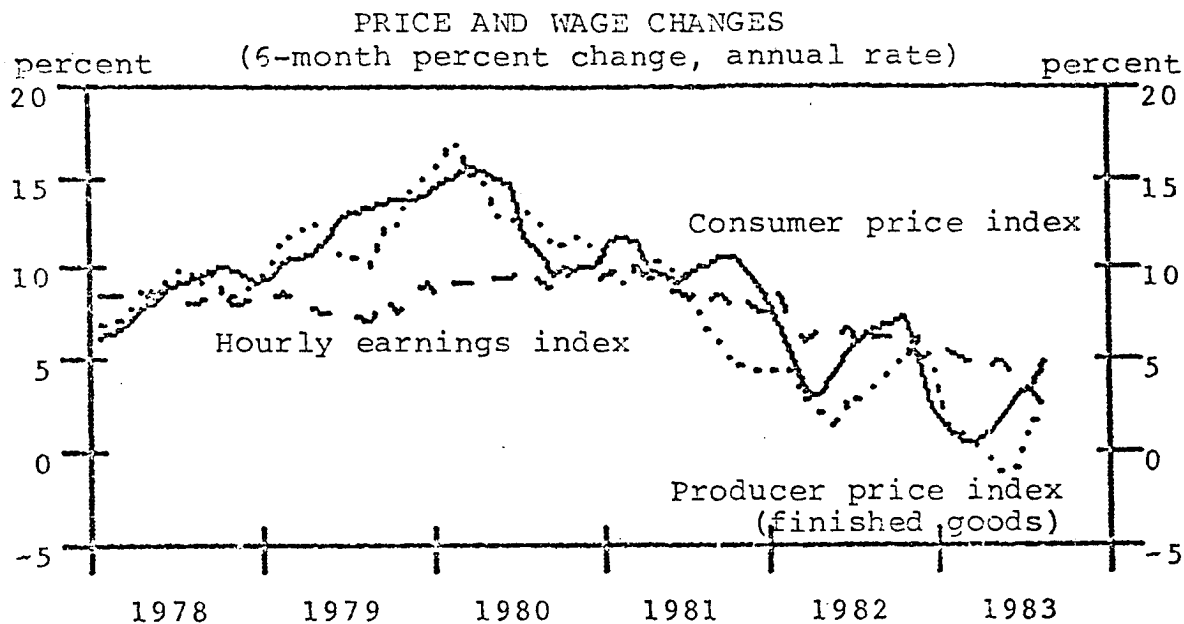
The producer price index for finished goods and the consumer price index both increased 0.4 percent in August. Over the last 12 months, the PPI has risen 1.4 percent and the CPI 2.6 percent. Though price declines during the early spring have been reversed, a significant acceleration of inflation is not likely in the immediate future.

- The Department of Agriculture now projects that the combination of the drought and the PIK program will reduce the corn crop 48 percent from last year's record to its lowest level since 1970; the soybean crop (which is not covered by PIK) will fall 33 percent; the sorghum crop will drop 43 percent. This misfortune will reduce real growth in the economy by about half a percentage point in the third quarter and possibly by more than that in the fourth. The overall effect on feed grain prices will be moderated by record carryover stocks from last year's bumper crops and good grain harvests in other countries.
- This summer's drought will push up some food prices in 1984, but the increment to overall inflation will be fairly small. The primary impact for consumers will appear in red meat prices. In the short-run, meat prices will be depressed by increased slaughtering as farmers respond to the increase in their costs. Reduced herds should cause meat prices to rebound during 1984 by more than they fall during the latter part of this year. The Agriculture Department raised its most recent forecast of food prices next year from an increase of about 4 percent to about 6 percent. If that estimate is accurate, it will add about half a percentage point to the overall inflation rate in 1984.
- Wage increases remain quite modest. The hourly earnings index, which advanced only 3.6 percent in the last 12 months, may increase somewhat faster as expanding profits prompt workers to bargain more aggressively and management to be more generous. In the first half of 1983, major collective bargaining settlements included life-of-contract increases averaging 2.7 percent, slightly greater than first-year gains averaging 0.9 percent. These increases are the smallest in the series' 15-year history.
- In addition to the contribution of moderately rising wages, large productivity gains have helped to hold down unit labor costs. Output per hour in the nonfarm business sector, excluding housing, grew at a 5.8-percent annual rate during the first two quarters of 1983, holding unit labor costs unchanged over the period. Productivity should continue to advance, though at a more moderate pace.

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Capacity utilization in manufacturing rose to 76.7 percent in August from its recession low of 69.6 percent. With growth in production slowing, utilization rates during the rest of this year and next are not likely to exceed the 82-83 percent level that has been associated with accelerating inflation historically. Utilization varies considerably among sectors.

- Of 17 major industries for which the Federal Reserve Board publishes capacity utilization measures, three have shown little improvement since their 1982-83 low points. Seven are approximately one third of the way back to their 1978-80 peaks and, on average, stand 19 percentage points below those peaks.
- Five industries--motor vehicles and parts, textiles, rubber and plastics, paper, and utilities--have climbed more than half way back to their highest utilization levels during the 1978-80 period. Excluding motor vehicles, these industries lack only 2.5 to 4 percentage points to reach their previous peaks. The paper industry has already passed its maximum of 95.1 percent in early 1980 with an August level of 95.6 percent.

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ECONOMIC INDICATORS

	<u>Aug</u>	<u>July</u>	<u>June</u>	<u>May</u>	<u>Apr</u>	<u>Mar</u>
<u>General Indicators</u> (% change)						
Composite Index of Leading Indicators	-0.1	0.8	1.9	1.2	1.3	2.0
Composite Index of Coincident Indicators	-0.4	0.7	1.4	1.7	0.7	0.8
Composite Index of Lagging Indicators	0.6	0.1	-1.1	-2.4	-0.7	-1.2
NAPM Composite Diffusion Index (percent)	63.6	67.1	59.6	55.1	57.1	54.7
<u>Employment</u>						
Total Employment (change in 000's)	296	495	1228	97	362	40
Payroll Employment (change in 000's)	-411*	358	423	331	276	68
Unemployment (change in 000's)	109	-556	-46	-136	-53	-109
Unemployment Rate (percent)	9.4	9.3	9.8	10.0	10.1	10.1
Initial Claims for Unemployment Insurance (000's)	408	380	406	453	470	479
Factory Workweek (hours)	40.3	40.2	40.1	40.0	40.1	39.5
<u>Production and Orders</u>						
Industrial Production (% change)	0.9	2.0	1.3	1.3	1.9	1.4
Capacity Utilization, Manufacturing (%)	76.7	76.2	74.8	73.8	72.9	71.6
Auto Production (mil. units, AR)	7.7	6.6	6.4	6.0	5.8	5.7
Total New Orders (% change)		-1.7	5.1	2.3	2.3	3.1
Nondurable Goods (% change)		0.2	2.5	3.0	0.3	2.9
Durable Goods (% change)	0.3	-2.9	7.6	1.6	3.9	3.2
Nondefense Capital Goods (% change)	5.9	-11.2	9.3	-1.6	12.8	4.5
<u>Inventories</u>						
Manufacturing and Trade Inventories (% change)		0.2	0.0	0.2	0.3	-0.9
Inventory/Sales Ratio		1.36	1.35	1.39	1.44	1.45
Chg. in Auto Inventories (mil. units, AR)	1.4	-0.4	-0.9	-0.6	-0.4	-0.4
<u>Prices and Wages</u>						
Consumer Price Index (% change)	0.4	0.4	0.2	0.5	0.6	0.1
Food (% change)	0.2	-0.1	-0.3	0.3	0.5	0.6
Energy (% change)	0.7	0.3	0.3	2.5	2.0	-0.9
All Other Items (% change)	0.5	0.6	0.3	0.3	0.4	0.2
<u>Producer Prices</u>						
Finished Goods (% change)	0.4	0.1	0.5	0.2	0.0	-0.3
Intermediate Goods (% change)	0.6	0.3	0.8	0.6	-0.5	-0.4
Crude Goods (% change)	2.1	-1.2	-0.1	0.0	1.6	0.7
Hourly Earnings Index (% change)	-0.1	0.3	0.1	0.4	0.4	0.0
Hourly Earnings Index (12-month % change)	3.6	4.3	4.6	4.8	5.2	5.4

*More than accounted for by 710,000 increase in workers on strike. Otherwise employment rose about 300,000.

ECONOMIC INDICATORS (cont'd)

	<u>Aug</u>	<u>July</u>	<u>June</u>	<u>May</u>	<u>Apr</u>	<u>Mar</u>
<u>Consumer Spending and Income</u>						
Personal Income (% change)	0.2	0.6	0.5	1.1	0.7	0.7
Wages and Salaries (% change)	0.4	0.7	0.5	1.2	0.9	0.7
Disposable Personal Income (% change)	0.2	1.7	0.4	0.7	0.9	0.8
Real Disposable Personal Income (% change)		1.1	0.4	0.5	0.1	0.6
Personal Consumption Expenditures (% change)	-0.3	0.6	0.4	1.7	1.7	0.8
Real Personal Consumption Expenditures (% change)		0.0	0.4	1.4	0.9	0.6
Retail Sales (% change)	-1.4	-0.2	0.8	3.1	2.3	2.3
Domestic New Car Sales (mil. of units, AR)	6.6	7.2	7.5	6.9	6.4	6.2
Saving Rate (percent)	5.2	4.7	3.6	3.7	4.6	5.3
Consumer Installment Credit (change, \$ millions)		4840	4406	2696	2271	2582
Consumer Confidence Index (Conf. Board)	84.2	84.7	84.9	84.0	80.3	77.1
Consumer Buying Plans (Conf. Board)	89.3	100.5	103.6	85.2	86.0	87.9
Consumer Sentiment (U. Mich.)	90.9	93.9	92.2	93.3	89.1	80.8
<u>Construction</u>						
Real Construction Expenditures (% change)		1.4	4.0	2.1	1.0	-0.3
Private Residential (% change)		3.2	5.7	4.3	5.6	2.4
Private Non-residential (% change)		-0.6	2.9	0.5	-3.3	-1.4
Public (% change)		1.2	3.2	1.0	1.0	-2.8
New Home Sales (% change)	-5.1	-8.6	0.2	4.7	3.9	3.0
Housing Starts (000's of units, AR)	1935	1785	1736	1807	1506	1605
Housing Starts (% change)	8.4	2.8	-3.9	20.0	-6.2	-10.0
Housing Permits (% change)	-7.3	1.2	7.7	6.4	4.7	-0.8
Mortgage Interest Rates, FHLMC (percent)	13.81	13.42	12.87	12.63	12.78	12.80
<u>Money and Credit Conditions</u>						
M1 (% change)	0.2	0.7	0.8	2.2	-0.2	1.3
M2 (% change)	0.5	0.5	0.9	1.0	0.2	0.9
Federal Funds Rate (percent)	9.56	9.37	8.98	8.63	8.80	8.77
3-month Treasury Bills, Auction Rate (percent)	9.39	9.12	8.82	8.19	8.25	8.30
Bank Prime Rate (percent)	10.89	10.50	10.50	10.50	10.50	10.50
Treasury Bond Yields (percent)	11.42	11.10	10.64	10.21	10.19	10.34
Corporate Bond Yields (percent)	12.86	12.46	11.90	11.24	11.58	11.81
Commercial and Industrial Short Term Credit (% change)	-0.3	0.1	0.2	-1.5	-1.0	0.3

ECONOMIC INDICATORS (cont'd)

	<u>Aug</u>	<u>July</u>	<u>June</u>	<u>May</u>	<u>Apr</u>	<u>Mar</u>	<u>Feb</u>
<u>International Trade</u>							
Merchandise Exports (\$ billions)	16.6	16.6	17.0	15.6	16.1	16.8	16.3
Merchandise Imports (\$ billions)	23.8	23.0	22.0	22.5	20.7	20.4	19.9
Trade Balance, c.i.f. (\$ billions)	-7.2	-6.4	-5.0	-6.9	-4.6	-3.6	-3.6
<u>National Accounts</u>							
	<u>1983</u>		<u>1982</u>				
	<u>II</u>	<u>I</u>	<u>IV</u>	<u>III</u>	<u>II</u>	<u>I</u>	
Nominal GNP (% change, AR)	13.3	8.2	2.5	2.7	6.6	-1.4	
Real GNP (% change, AR)	9.7	2.6	-1.3	-1.0	1.0	-5.5	
Real Disposable Income (% Change, AR)	3.5	2.9	2.6	-0.3	1.9	-1.9	
Real Consumption (% change, AR)	10.0	2.9	3.6	0.9	3.1	2.4	
Real Nonresidential Fixed Investment (% change, AR)	7.9	-1.5	-6.6	-8.8	-14.3	-5.9	
Real Residential Fixed Investment (% change, AR)	79.5	57.3	53.2	-13.0	17.9	-28.5	
Housing Starts (000's of units, AR)	1683	1694	1261	1122	950	903	
Change in Business Inventories (\$72, billions)	-5.4	-15.4	-22.7	-1.3	-3.4	-10.2	
Net Exports (\$72, billions)	12.3	20.5	23.0	24.0	33.4	35.2	
Real Government Purchases (% change, AR)	-1.1	-8.8	10.6	9.4	-5.0	-0.2	
Fixed-weighted Price Index (% change, AR)	4.3	3.4	4.7	5.9	4.7	5.3	
<u>Corporate Profits (% change)</u>							
Before-tax (current production)	20.0	12.3	-3.9	1.0	3.0	-15.6	
After-tax (current production)	18.2	11.5	0.3	2.2	3.5	-12.6	
Before-tax (book)	19.8	1.3	-5.5	-0.8	3.2	-20.3	
After-tax (book)	17.6	-4.7	-2.6	-0.8	4.0	-20.3	

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